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Trusts - Their Use & Operation in Estate Planning

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Farm Management Papers 2

TRUSTS
THEIR USE AND OPERATION
IN ESTATE PLANNING

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INTRODUCTION

Trusts were first created in England many centuries ago by settling property upon protective Trusts whereby the income was paid to successive generations whilst the corpus was maintained intact thereby avoiding death duty.

To prevent this, rules were formulated some 250 years ago to prevent the indefinite "tying-up" of property and these still apply today and are generally referred to as the Rules Against Perpetuity. In New Zealand these Rules have recently been amended but briefly they are to the effect that property may be placed in Trust for the period of a life in being plus 21 years thereafter or for 80 years. Similarly until the Perpetuities Act, 1964, it was permissible to accumulate income only for a very restricted period and as a result the compilers of Trust Deeds had to be wary that they did not infringe this law which became known as the rule against accumulations. This, however, was abolished with the Perpetuities Act, 1964, and it is now permissible to accumulate income for the full period of the Trust.

Many notable authorities have upheld the right of the individual to order his affairs in such a way as to preserve as much as possible of his funds intact for transmission to his beneficiaries. The classical dictum which has been quoted in many subsequent cases was that of Lord Tomlin in the Duke of Westminister v Inland Revenue Commissioners (1936) when he said, "every man is entitled if he can to order his affairs so that the Tax attaching under the appropriate Acts is less than it otherwise would be".

Planning an Estate and the introduction of a Trust into that plan requires a careful consideration of many varied, and often conflicting objectives. It also involves assessing existing problems and visualising those that may develop in future.

Functions of a Trust

The purpose of a Trust in the context of estate planning is primarily a means of disposing property when something more complicated than an immediate out-and-out gift is intended. Marriage settlements, advancements for a son, funds in accumulations for children and grandchildren, charitable dispositions, and so on, come to mind. These are the historic functions for a Trust but with modern taxation it has become useful for a variety of other purposes. It is being widely used to relieve the burden of tax on the settlor. Under any scheme of taxation employing progressive rates it is obviously less costly to have lower rates imposed on several individuals than to have a high rate on the one person. In some countries this benefit has been nullified by changed legislation and under recent legislation, in particular the provisions of the Land and Income Tax Amendment Bill No. 2, 1968, this country has also placed curbs on the taxation benefits that can be gained from future Trusts under this heading. There is still, however, benefit to be obtained in certain circumstances. Similarly Trusts are being used both to lessen the burden of death duty and also to provide a fund out of which death duty itself may be paid.

Who is a Trust For

The use of Trusts in estate planning should be reserved for the person of substance. As to when a person may be deemed to be "of substance" is difficult to define and must vary from case to case, but generally speaking a person whose net estate is \$80,000 should be giving consideration to estate planning, similarly a man whose income is over \$6,000. Trusts should be used purely to take the "cream" of the top of a person's estate or income and no scheme of Trusting should ever be devised that will leave a man with no capital other than a few control shares in a Company, or reduce him to a state where he is not completely independent.

Objects

It therefore follows that the objects of a Trust in estate planning would fall under one, or a combination, of the following headings:-

(a) To spread taxation, but this must be incidental to the overall scheme and not the prime objective.

(b) To reduce estate and save duties.

(c) To peg the value of the estate.

(d) To provide a platform for the future reduction of the value of the estate.

(e) To provide a fund for the payment of death duties.

To Spread Taxation

For the man with a large income and a young family the advantages of spreading income over the family are obvious. For example, the self-employed man with a wife and four children paying $650 in Life Insurance premiums and an income of $10,000 would pay tax of $3,316.20. If a scheme were devised, whereby $4,000 of this income were to be diverted from him to a Trust for the benefit of his wife and four children and the income in the Trust were treated as follows:-

Wife	$ 300
Four Children - $700 each	2,800
Accumulated	900
	$4,000

the family tax would total $1,478.34, a saving of $1,837.86 per annum at 1968 rates of taxation.

Under the provisions of the No. 2 Amendment Bill, 1968, of the Land and Income Tax Act, family Trusts fall to be taxed under two headings:-

1. Those formed prior to 19 July 1968
2. Those formed after 19 July 1968

The example quoted above is for a settlement under a Trust falling under category 1. Should the Trust not have been formed prior to 19 July 1968 and the settlement thereby come under category 2. taxing would have been different. Assuming that the four children were minors and that there was **during** the tax year or within six months thereafter, $700 **paid or applied** on their behalf, then their position would remain unaltered. It is chiefly in what is termed "Trustee's Income" that the difference arises. In this case the $900 accumulated will be taxed at the rate of .35c in the $ and the overall effect would be to increase the tax for the family to $1,650.84. This, however, still shows a saving of $1,665.36 per annum at 1968 rates of tax.

A clear understanding is necessary of the provisions of this recent amendment. If only affects Trusts formed after 19 July 1968. The principal alterations are in the field of minors' income and "Trustee's Income". In the former case only income "paid or applied" during the income year or within six months thereafter will be allowed as children's income. In the latter case "Trustee's Income" no longer enjoys a tax exemption and includes income not actually "paid or applied" when the beneficiaries are minors. The rate of tax is .35c in the $ or the normal rate applicable, whichever is the higher.

There have been many cases on the subject of "pay and apply" but this amendment defines it as a bona fide transaction which places the income in question beyond the possession and control of the Trustee in his capacity as Trustee of that particular Trust.

To Reduce Estate and Thereby Save Duties

This requires little in the way of explanation as it follows that any reduction in a person's estate reduces the ultimate death duty payable. Consequently where it is not convenient to make direct gifts to beneficiaries or where it is intended to gift a large asset over a period of time to a class of beneficiaries, use may be made of a Trust.

To Peg the Value of the Estate

Use is made of Trusts under this heading in cases where a person has an estate of a desirable size but in that estate is an asset that is continually increasing in value, for example, a commercial building in a progressive centre, or where the person has as before an ample estate but is about to embark upon a new venture which it is anticipated will prove financially rewarding.

In the case of the person with the commercial building, if he were to transfer this property by way of sale to a Trust at its present Government value and leave the whole of the purchase money owing by the Trust to him, he would have "pegged" the value of his Estate in so far as this property is concerned at its then Government value. He would at the same time have provided himself with a platform for the future reduction of his estate in that he could if he so desired from time to time reduce the amount owing by the Trust to him by gift.

Trusts are frequently taken advantage of by successful business men who intend entering a new field or branch out on a different aspect of their existing business. This has applied in cases where land has been purchased for the purpose of subdivision and resale where the purchase and subdivision has been carried out through a Trust.

To Provide a Platform

It follows that once a Trust has been formed the settlor has provided himself with a platform from which he can in the future reduce the size of his estate either by way of making further additions to it, either by way of gift or sale, or by reducing by way of gift the amount owed to him by the Trust.

To Provide a Fund for the Payment of Death Duties

The principal method of covering death duties is with life insurance but to the person with a substantial estate, the taking of further insurance is merely to attract more duties and it is difficult to catch up. Quite frequently this extra insurance is taken by a son or sons on the father or by the wife, but in these cases many difficulties can and do arise.

Firstly, the father does not always die first and in this case difficulty is frequently found in meeting the premiums. Should the son be the insurer and die shortly after his father it is expecting a lot of the son's widow for her to hand the proceeds of the policy which she has inherited, over by way of a loan, to her in-law's estate for the payment of death duty. To the person of substance it must be of importance to know that life cover taken out for the purposes of covering death duty will in fact be available for that. Any Trust created prior to 19 July 1968 for the benefit of the same persons who benefit under the settlor's Will, and with the same Trustees and with sufficient income to cover the premium will do this. The Trust must have been created for a period sufficiently long to cover the settlor's life span but must make no reference to Settlor's death. The settlor would sell to the Trust the life policy for its surrender value. The ideal Trust would have a sufficient income to cover the premium and if the premium were less than \$100 such income being treated as "Trustee's Income" under the Land Income Tax Act, 1954, would be free of income tax, a situation that cannot be obtained if the policy were transferred to some member of the family. Should there be no such Trust in existence then a Trust containing these terms could be created. Under the provisions of the Estate Gift Duties Act, 1968, it is no longer of importance who pays the premium. Providing the principal had no beneficial interest in the policy for three years prior to his death no part of the proceeds of the policy will fall to be included in his estate. Consequently, it is no longer necessary to provide the Trust with income producing assets to cover the premium. The principal can assign either by way of sale or gift, his interest in a policy to a Trust along the lines set out above, and if he should so desire, continue to pay the premium himself. Under present legislation this premium would continue as a taxable allowance to him but the proceeds of the policy would be outside his estate. If he continued paying these premiums until death the last three premiums would be added back into his estate as gifts as being made within three years of death. On death in either case the Trustee of the Trust under the wide powers given him under the Trust Deed would lend the proceeds of the life policy to the estate for duty purposes. In that the beneficiaries of both the Trust and the estate are the same, the two funds would then become one.

Beneficiaries

To gain the greatest benefit it is desirable that the Trust be discretionary, particularly in regard to the distribution of the annual income. The settlor generally desires to benefit his wife and children but it is wise to provide in the Deed also for grandchildren to cover the event of any of the children dying during the period of the Trust leaving children. Difficulties have arisen with the Inland Revenue Department in regard to the treatment of income not actually paid or applied for the benefit of minors. In cases of Trusts created prior to 19 July 1968, the decision depends on the wording of the Trust instrument and the actions of the Trustees. The drawing of the Trust document is a matter for the Solicitor but it is only reasonable that we should give him a clear indication of how it is desired to treat the income. To overcome this difficulty many Deeds provided that the Trustee shall have the discretionary right to pay or apply income for the benefit, maintenance or education of any of them, the wife, the children, or the grandchildren, and then continue to authorise the Trustee to accumulate and add to capital by resolution and conclude by stating that any income not treated by the Trustee in any of the foregoing ways shall in respect of each year ended on 31st March vest in the children equally.

As a result of the No. 2 Amendment Bill, 1968, referred to above, this provision cannot apply in Trusts drawn after 19 July 1968 in the case of minor children in that only income "paid and applied" on their behalf can be classed as theirs for taxation purposes. However, it is still considered a desirable clause as the children are not always minors, and it is a clear indication to the Trustees, all things being equal, as to how Settlor wishes the income to be distributed.

Such a provision gives the Trustee the opportunity of fully reviewing the situation and allocating the income in the manner gaining the greatest tax savings, always bearing constantly in mind as to what is most desirable for the family.

Deeds created prior to 19 July 1968, frequently provided that income vested in minors remained subject to the powers contained in the Trust Deed until such time as they are in fact paid or transferred to such beneficiary. There is some argument as to the validity of this clause, but where it is not included, the vested income monies become held up on statutory Trusts by the Trustees and as such should be separately invested in Trustee securities. In that, with certain exceptions, a minor cannot make a Will, difficulties can arise in the case of the death of such a beneficiary who has a large accumulated income account. In such circumstances the monies would pass as on intestacy and would go thereby normally to the mother and father equally. However, as the mother and father, under provisions contained in the Administration Act, could renounce their interest in the child's estate thisdifficulty can be overcome. Under the 1968 Amendment Bill No. 2, referred to above, this situation will no longer arise as monies to vest in a minor, must leave the control of the Trustees of such Trust.

It is submitted that the ultimate beneficiaries should invariably be the children. It is appreciated that greater duty savings can be obtained by making the grandchildren the ultimate beneficiaries but in these cases the final beneficiaries are frequently unknown to the settlor. Furthermore most parents like to make their own arrangements for their children and do not like to have that right taken out of their hands.

Period of the Trust

This should always be kept realistic. As previously mentioned under recent legislation it is possible to "tie up" a Trust for a period of 80 years or a life in being and 21 years. There are many Trust Deeds in existence which provide for the Trust to run for 80 years, or such shorter period as the Trustees may decide. In these cases should the Trustee decide to distribute in, say 20 years, it is suggested that the next generation, who would have inherited had the Trust run its full 80 years, could have a claim against the Trustees for exercising unfair discretion in favour of a class, namely the earlier generation.

Generally speaking, the settlor desires the trust to run for sufficiently long to cover both his and his wife's life span and finally to knit in with his Will. In such cases it is a reasonably simple matter to establish the expectation of life of the younger and then to provide for the Trust to run for that period or for such shorter period as the Trustee may decide.

Methods

In determining the scheme of the trust it must always be remembered that we are dealing firstly with people. Therefore we must devise a scheme to suit the family concerned, and we should not endeavour to make the family suit the scheme even if it does save more in taxation or duty. It is imperative, in the formation of a successful scheme, that the ultimate desires of the settler be clearly understood and never forgotten. Generally speaking, the simpler the scheme, the more successful it is.

To gain the greatest benefit from a taxation point of view it is desirable to endeavour to provide the trust with an asset that will earn for the trust income that has not borne any tax. A simple form of trust is to provide it with a holding of shares in a company, but the dividend paid to the trust arises from a proportion of the company's profit left <u>after</u> the company has paid tax. To take full benefit of the beneficiaries' personal allowances the aim should be to have untaxed income come into the trust.

To do this it is necessary for the trust to either conduct a business or possess an interest earning asset or one that may be rented. The city or town businessman frequently owns the premises from which he operates principally to obtain security of tenure. If he were to sell these premises to a trust for the benefit of his wife and family, the sale price being the up-to-date Government value, and the purchase monies being left owing to him by the Trust on demand and free of interest, he could then rent those premises from his family trust. Whether he operates in his own name or through a company is immaterial, the rent would be a tax deduction to his business and by being spread amongst his family in the trust could show a marked tax saving. At the same time the settlor would have pegged the value of his estate in so far as that building is concerned, and also would have provided a platform for the future reduction of his estate in that he could from time to time make gifts to his trust in reduction of the amount which it owes him. Exactly the same procedure may be followed in the case of farmers in dealing with their farms. In these cases the manner in which the farmer wishes to eventually dispose of his farm must always be kept in mind. If it is his wish that his farm should pass to his eldest son at a certain stage and at a certain price (possibly Government valuation), provision to this effect must be made in the trust deed.

Frequently, the private company is found to be the stumbling block to family happiness. Too often it is found that a businessman has formed his business into a company and transferred to it all his assets including realty. Outside of this practically all that he owns is his home. Probably, when being advised along these lines he has been told that so long as he holds the majority of shares or the control shares he can vote himself a salary. This is no doubt true, but generally insufficient regard is paid to the position that will arise on his death. If he left his wife the income for life, she would have to wait till the company declared a dividend after his death before she would receive anything from his estate. Then she would receive only the profit left after taxation and would lose thereby the maximum benefits of the $936 income tax free allowance and the allowance for any children there may be.

In the event of such a situation one solution would be the creation of a trust providing for the income to be distributed at the trustee's discretion amongst any one or other of the man, his wife or children, with the children being the ultimate beneficiaries. The company should then sell to the trust its land and buildings for its up-to-date Government valuation, leaving the purchase price owing to the company on demand and free of interest. The company would then proceed to rent the premises, the rent being disbursed each year amongst the family. It is not always necessary or desirable that the principal be included as an income beneficiary, but this would give him added protection in the event of the sale of the business and the resultant income from the proceeds being insufficient to provide for his needs. Such a scheme would provide a ready income for the wife and children in the event of the man's death and immediately give a saving in taxation.

It is recommended that all transactions between the settlor and his trust be generally by way of sale and purchase with at a later date a gift of the consideration or part thereof. This clearly records the transaction. In addition a saving in Gift Duty is effected by spreading it over a number of years.

As always, there is the odd exception and upon occasion this can be used most advantageously. As an example there is the case where the asset being sold to the trust is to be resold. If the asset is acquired for purposes of selling or otherwise disposing of, the profit will be assessable under Section 88 (c) of the Land and Income Tax Act 1954, but if the asset has been a gift the proceeds of sale would not be assessable as no profit is made on realising a gift.

A simple form of trust can be the answer for the elderly person with an estate of $60/70,000, of which $40/50,000 is income producing, and who desires to reduce his estate for duty purposes, while at the same time requiring the bulk of his income to live on and not wishing during his life to pass assets directly over to his next of kin. The beneficiaries would be the same as under his will and the period would be such as would cover his life span with power to the trustee to shorten this period. The trust having been created, the whole of the income earning assets could be sold to it. Each year he could charge a sufficient interest that will give him the income he requires and the balance could be either accumulated in the Trust and suffer tax at the rate of .35c in the $, or be distributed amongst his family. Each year the debt may be reduced by way of gift and in addition any increase in the value of the assets would be outside his estate. Should his life continue considerably longer than anticipated he could cease making gifts and charge a higher rate on the balance then remaining. This scheme is also adopted in the case of New Zealand residents with large overseas assets. By selling the overseas assets to a trust and taking an acknowledgement of debt for the consideration, they remove these assets from their estate thereby removing the need to reseal the estate overseas. This gives a large saving in time, costs, and to a lesser degree, duties.

Interests in Estates

Frequently a person already has a large estate included in which is a vested interest in another estate, say the father's, with enjoyment postponed during a life interest, say the mother's. In these cases great benefit can be obtained by the use of a trust. The actual value of the vested interest is the present value of the estate <u>less</u> the value of the life tenant's remaining interest. Such naturally is always less than the amount that will eventually be received. If a Family Trust is set up and the interest in remainder sold to it, the settlor immediately establishes the value of that interest in so far as his estate is concerned, and also makes a duty free gift to his family of the difference between such value and the amount eventually inherited. In that he is selling something that he has never enjoyed the loss is unnoticed, and if funds are required by the settlor at such time as the inheritance is received he can always call for a repayment on account of the monies owed to him by the trust.

Trusts for Persons with Large Incomes but Small Asset Backing

This is always a difficult case and the counsellor must watch very closely that his scheme does not fall to be attacked under the provisions of Section 108 of the Land and Income Tax Act. The line of demarcation under this section is narrow and is very difficult of definition. The clause in its widest sense would appear to catch almost any transaction, but up to the present, the cases that have been taken and won by the Inland Revenue Department under this section would make it appear that the intention is to cover only blatant cases of income switching. This applies to trusts that have no substance in the way of assets and, therefore, must have been created purely to switch income.

It does however frequently happen that persons in receipt of large incomes but with insufficient asset backing to warrant the transfer of an effective asset to a trust, seek assistance. In these cases good use can be made of companies. The maximum tax saving will not be made but there could be a reasonable saving. The company would have a small capital and be established only for the purpose of carrying on the business. Its capital could comprise say $1,000, made up of 20 "A" shares with 50 votes each and 980 "B" shares each having one vote. The "A" shares would be taken up by the principal and the "B" shares by the trust.

To avoid the application of Section 108 this would ideally be formed to commence a new venture. If the person is already engaged in business that is not operating as a company, the formation of the company to take over the business must appear as a normal prudent step and not as one purely for the purpose of transferring the income to a company and thence to a trust.

Retaining Initiative

The operation of any trust must never hamper the initiative of the future generation. Generally it is formed for the purpose of assisting the children and it must be closely watched that the plan adopted is one that will achieve that object and not in fact tie the family into a web from which they find great difficulty in escaping.

A possible example of this is the case of a farmer faced with the problem of whether to form a company as opposed to a trust.

There are few advantages to a company holding the farmland as opposed to a trust. Generally the principal reason for choosing a company is to allow the father to maintain control even in his old age.

It can well be argued that this is not an unreasonable suggestion but what will be the effects on the next generation? Let us assume that the farmer has three sons, all married. Should the farm be large and all sons be employed by the company and although the father holds the control shares they each have a substantial holding of non-voting shares, the question arises of their future and also the manner in which they should provide for their wives. Frequently it is found that each son vies with the other to have a better home, better car, and do less work, as each is on a salary and everything is charged to "the company." The next problem is what happens in the event of the death of one of the sons. Although his estate may be of quite considerable size, to his wife it may be practically valueless. His salary will have stopped and the widow will be dependent upon what dividend the company will be able to pay which in family farming companies, after salaries to working members of the family and taxes are paid, is generally very small. Even if the sons survive the father the problem of control arises. Unless the company goes into liquidation (and this could be difficult to achieve through problems in attaining the necessary majority or expensive owing to large undistributed profits arising from mortgage repayments and capital expansion) it would be almost impossible for any son to arrange his personal affairs to his satisfaction. Should only one son be farming the problem could be even greater. Had the farmer transferred the farm to a trust and rented it back the position would have been more fluid and the sons would not have been tied to that family knot "the company." The farmer would have lost control of the farm but such control would be in the hands of the trustee who is after all his nominee. Had the sons all been working on the farm they could have been in partnership and possibly had definite ownership of the stock. Alternatively the trust could have leased or sold them one-third of the farm each. Had the farm been big enough to form two units only, such units could have been sold to two sons who would have raised sufficient monies on first mortgage to pay into the trust enough to enable the third son to purchase a further unit. In addition in the interim period between the formation of the trust and the sons taking up farming the taxation saving, with the three sons, the wife, the husband and the trustee sharing the income between them, would in practically all cases have been greater. If the company is used to save tax by accumulating income the day of reckoning is merely postponed to the ultimate day of liquidation.

Follow-up and Recording

Having established a trust the practical side of carrying it into operation and of the recording of all steps must not be overlooked. It is desirable that the whole situation be reviewed every year and the ideal time to do this is when the annual accounts are prepared. At this time gifts for the forthcoming year and the disposition of the Trust funds may be determined. Any transaction affecting the Trust must be carefully recorded, as should the trust be attacked by the revenue authorities at any time, the principal points to be determined would be the terms of the trust and the actions of the trustees. The trust is normally reduced to writing in the form of a deed which can be argued upon but frequently the actions of the trustees have not been recorded and in these instances are always difficult, if not through death impossible, of interpretation. It is therefore essential that full minutes be kept of all decisions made by the trustees and that these minuted be signed by the trustees.

Partnerships

Partnerships as between settlor and the trustees are generally to be avoided. There are practical difficulties involved in a trustee becoming a partner and in addition difficulties arise with the Tax Department in apportioning the income. The main practical difficulties are the unlimited liability of the trustee as a partner and his problem of working as a partner.

Problems of Trustees

Accountants frequently find themselves acting as a trustee of Family Trusts, and there are certain pitfalls to be avoided. It must be remembered that when a trustee enters into a business or partnership on behalf of his trust he does so in his personal capacity and as such his liability is not limited to the assets of the trust. Providing settlor is substantial, and that is invariably the case, it is always wise to obtain from him an indemnity against any loss. Similarly should a trustee on behalf of his trust subscribe for, or take over shares that are not fully paid up and there be a call made on those shares that the trust cannot meet, the trustee is again personally liable.

The duties of a trustee are onerous and it is imperative that anyone appointed a trustee take his duties seriously and does not in fact leave the administration in the hands of the settlor for in so doing he may well be building up a claim against himself in the future for wrongful administration resulting from financial loss to a beneficiary or group of beneficiaries.

Conclusion

Finally it should be emphasised that any duty or tax saving scheme should be undertaken in moderation. The wish to save taxation and avoid duty should never be allowed to outweigh what is for the ultimate good in preserving family harmony, initiative in the next generation, and above all complete protection to the settlor during his life.

EXAMPLE No. 1.

Showing advantages in a trust taking a transfer of realty from a company as opposed to taking a holding of shares in that company.

A and B each hold 50 per cent of the shares in a manufacturing company which operates from premises owned by the company. Government value of the premises is $48,000. The company has grown from small beginnings to where the shareholders' equity is now conservatively $160,000. Net profit of company is $22,000. Outside the company A and B only own homes. Each is married with young families of four and five children respectively.

The problem arises concerning the position of the wife and children on the death of either principal. At present the widow would be dependent upon the dividend paid by the company. Each principal now draws a salary of $7,000 and has only a small advance account in the company.

Suggested Solution

Each principal creates a discretionary trust with the sum of $100 for the other principal, his wife and children with the children being the ultimate beneficiaries. Each trust to have a common trustee.

Each trust buys from the company an undivided half interest in the premises for $24,000 each, the whole of the purchase monies to remain owing to the company on demand and free of interest.

The company then rents from the trusts the premises for $4,800 per annum clear of all outgoings. Each trust would then receive an income of $2,400.

Suggested Distribution

	$	$	$
"A's" Trust:			
Wife	.. 300.00		
4 children @ $500	..2000.00		
Trustees	.. 100.00		
		2400.00	
Taxes	..		129.50

	$	$	$
"B's" Trust:			
Wife	.. 300.00		
5 children @ $400	..2000.00		
Trustees	.. 100.00		
		2400.00	
Taxes	..		113.90
Total Taxes for both Trusts	..		243.40

Previous taxes on the same $4800 made available to shareholders:

	$	$
In company @ 50c in $	.. 2400.00	
Balance of $2400 in shareholder's hand as dividend @ 35c in $ ..	.. 84.00	
		3240.00

Taxation saving $2996.60 per annum.

In addition in the event of the husband's death there is a regular income of $2400 available for the widow and children and they are therefore not entirely dependent upon what dividend may be paid by the company.

EXAMPLE No. 2.

Showing the benefit of the use of a company where the capital would not normally be large enough to suggest the use of a trust.

A professional man who has a large income and little assets and a wife with a reasonable cash sum available for investment. There is a family of two boys, 10 and 8, and a daughter of 4, all to be privately schooled.

Husband's assets	Home, car and practice.
	Shares and cash, say $4000.
Income	$9000.
Wife's assets	Cash $29,000.

There is available for purchase with the use of borrowed money commercial premises for $50,000 which will produce a net income of $5000 per annum (subject only to interest on borrowed monies).

Estate duty is no problem but taxation is heavy.

Potential Taxes

Husband on $9000 ($650 life insurance) ...	$2925.85
Wife, if property were bought in her name, on $3460 ($5000 less interest $1540) ...	693.17
	$3619.02

A suggested scheme which will retain for the wife control of her assets, access to her present capital and full access to all income should her husband, because of sickness, be unable to work, would be:

1. Wife to create a discretionary trust for the benefit of her husband and children for a period of 50 years or such shorter period as the trustees may decide. She pays $100 into trust and lends the trust the further sum of $20,800 on demand and free of interest.

2. A $1000 company having 1000 $1 shares divided into

100 "A" shares each having 10 votes and 900 "B" shares each having 1 vote should be created. The wife subscribes for the "A" shares and the trust for the "B" shares. The company contracts to purchase the property. To enable this to be financed the wife lends the company her remaining $8000 at 7 per cent interest and the trust lends the company $20,000 at 10 per cent interest. (The interest rates may be varied within reason as circumstances change). The wife draws $500 per annum for managing and directing the company.

3. Income Situation:

			Tax
Husband as before		9000	$2925.85
Wife:			
Interest ...	560		
Salary ...	500		
		1060	68.02
Company ...	...	... 400	83.33
Trust:			
Interest ...	2000		
Dividend, say	300		
		2300	145.70
($300 Interest accumulated and balance divided equally amongst children).			—
			$3222.90

Saving in taxation approximately $396.12 per annum.

Such a scheme provides protection for the wife and at the same time gives each member of the family sufficient untaxed income to cover a large portion of their exemptions.

EXAMPLE No. 3.

Covering Death Duty

A farmer aged 50 and fully insurable has a net estate of $200,000 with three young sons whom he hopes one day will take over his farm. He has made no provision for death duties which would amount to $80,000. He is afraid that if he were to die prematurely the farm or a large proportion of it would have to be sold. He has asked whether a scheme could be devised whereby death duties could be covered at all times and at the same time provision be made for his three boys, at some future date, to take over his farm in a partnership or by way of a partition. His wife must also be protected for her life.

His assets are:

	$
Farm – Government valuation ..	130,000
Live and Dead Stock	60,000
Cash	6,000
Car & Personal Effects	4,000
	200,000

His annual income is approximately $15,000.

His principal asset and the one most likely to increase in value is his farm so the value of this must be firmly established.

Suggested Scheme

A Discretionary Trust is created with the sum of $2000 for the benefit of the farmer's wife, sons and grandchildren, with the ultimate beneficiaries to be the sons with a gift over to the children of any son dying during the period of the trust. The period of the trust to be the wife's life, or 20 years, whichever is the greater, or for such shorter period as the trustees in their absolute discretion may decide. The trust deed to contain the usual wide powers which would include the power to accumulate income and keep up any policy of life insurance.

The farm should be sold to the trust for its up-to-date Government value of $130,000, the trustees executing a Deed of Acknowledgement of Debt in favour of the farmer for the full consideration which would remain owing on demand and free of interest. The farmer then should lease the farm from the trust paying a rental of $6500 clear of rates and insurance.

The farmer should take a reducible life policy for $80,000 and immediately sell it to the trust for the amount of the first premium. The trust should then maintain the policy from the rental. The actual application of the rental in the trust for tax purposes may be decided each year, depending on the incomes of the sons. The farmer should then commence upon a gifting programme with the intention of reducing his estate to $100,000 over the next ten years, commencing with annual gifts of $10,000 in reduction of the monies owed to him. After three years when the first gift becomes effective, review the amount of insurance cover and reduce it to the amount then required.

Such a scheme would give the farmer total death duty cover at all times, and through ownership of the live and dead stock and the debt owed to him, complete security, and through his Trustees provision for the sons to take over the farm.

Whilst the sons were small and with provision that income may be used for their maintenance the tax position could be:

				$
Allocation of Trust Income:				
Wife	...	...	...	300.00
Accumulated	...	...	...	4502.00
3 Sons @ $556 each	...	...	...	1698.00
				$6500.00
Total Tax	...	...	...	1663.15
Available Income	...	...	...	$4836.85
Farmer's Tax:				
Previously	...	...	...	7174.80
Less Payable – now	...	...	...	2795.40
				$4379.40
Less Tax paid by Trust	...	...	...	1663.15
Tax Saving:	...	...	...	$2716.25

If therefore the premium on the life policy were $3000 per annum the tax saving would nearly cover this and the farmer would have the cover that he required at very little additional cost.

titles published or in press :

No. 1 Farm Management Papers
An Evaluation of a Farm Irrigation Project.
R. D. Plank, T. Heiler, A. Taylor.

No. 2 Farm Management Papers
Trusts - Their Use and Operation in Estate Planning.
J. H. D. Wickham

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